

REVISED DIRECT TESTIMONY
OF
MIKE OSTRANDER

Accounting Department
Financial Analysis Division
Illinois Commerce Commission

CENTURYTEL, INC. and
GALLATIN RIVER COMMUNICATIONS, LLC
d/b/a CENTURYTEL OF ILLINOIS

Joint Application for Approval of a
Reorganization pursuant to Section 7-203
and Section 7-204 and for Other Relief

Docket No. 08-0645

January 16, 2009

1 **Witness Identification**

2 **Q. Please state your name and business address.**

3 A. My name is Mike Ostrander. My business address is 527 East Capitol Avenue,
4 Springfield, Illinois 62701.

5 **Q. By whom are you employed and in what capacity?**

6 A. I am an Accountant in the Accounting Department of the Financial Analysis
7 Division of the Illinois Commerce Commission ("ICC" or "Commission").

8 **Q. Please describe your professional background and affiliations.**

9 A. I received a Bachelor of Business Administration in Accounting from the
10 University of Notre Dame. I am a Certified Public Accountant and a Certified
11 Internal Auditor. I joined the staff of the Commission ("Staff") in March 2006.
12 Prior to joining the Commission, I was employed for three years as a staff
13 accountant in public accounting, seventeen years in private industry with
14 positions ranging from accounting manager to corporate officer encompassing all
15 areas of accounting and internal auditing, and three years as controller of a law
16 firm and software company.

17 **Q. Have you previously testified before any regulatory bodies?**

18 A. Yes. I have testified on several occasions before the Commission.

19 **Purpose of Testimony**

20 **Q. Please describe the proposed transaction.**

A. CenturyTel, Inc. ("CenturyTel") and Gallatin River Communications, LLC d/b/a CenturyTel of Illinois ("Gallatin River") (collectively, the "Joint Applicants") seek approval of a reorganization pursuant to Sections 7-203 and 7-204 of the Illinois Public Utilities Act ("Act"). CenturyTel is a publicly traded company that is the ultimate parent company of Gallatin River. Gallatin River is an incumbent local exchange carrier in Illinois. CenturyTel has entered into an agreement to acquire Embarq Corporation ("Embarq") through a stock-for-stock transaction. Embarq will become a direct wholly-owned subsidiary of CenturyTel. Gallatin River will remain a subsidiary of CenturyTel.

Q. What is the purpose of your testimony in this proceeding?

A. My testimony addresses the compliance of the proposed reorganization of CenturyTel and Gallatin River with respect to Section 7-204(b)(2) and 7-204(b)(3) of the Act. I also provide a recommendation to the Commission regarding its ruling on 7-204(c).

Compliance with Section 7-204(b)(2)

Q. Describe the requirements of Section 7-204(b)(2).

A. Section 7-204(b)(2) requires that, before approving a proposed reorganization, the Commission find that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers.

Q. How does the proposed reorganization impact the opportunity for Gallatin River to unjustly subsidize non-utility activities by utility operations?

A. The proposed reorganization of CenturyTel and Gallatin River does not impact the opportunity for the subsidization of non-utility activities of Gallatin River by utility operations. There is no change that will occur that affects the opportunity for Gallatin River to subsidize non-utility activities by the utility operations. In direct testimony, Joint Applicants' witness G. Clay Bailey testified that neither the Embarq acquisition nor the change in ownership of CenturyTel will result in the unjustified subsidization of non-utility activities by Gallatin River or its customers (Joint Applicants' Exhibit 1.0, pp. 18-19).

Q. By what means can the Commission be assured that Gallatin River will not unjustly subsidize the non-utility activities by its utility operations?

A. Gallatin River is subject to the cost allocation requirements of 83 Ill. Adm. Code 711, its cost allocation manual, and FCC cost allocation rules. The proposed transaction will not change the existing cost allocation procedures or accounting methods, as testified to by Mr. Bailey (Joint Applicants' Exhibit 1.0, page 19). In addition, Gallatin River has agreed to the following conditions from the Order in Docket No. 07-0043 as further evidence of compliance with Section 7-204(b)(2):

1. Commission Staff will be granted access to all books, accounts, records and personnel of CenturyTel, Gallatin River, and all of their utility and non-utility affiliated sister and subsidiary companies, as well as independent auditor's working papers, to the extent permitted by the rules and policies of the independent auditor;
2. Gallatin River will continue to comply with 83 Ill. Admin. Code 711, Cost Allocation Rules for Large Local Exchange Carriers; and
3. CenturyTel, Gallatin River, and all their utility and non-utility affiliated sister and subsidiary companies will conduct bi-annual internal audits, conducted in odd-numbered years, to test compliance with Section 7-

204(b)(2) and 7-204(b)(3). The internal audit report documenting findings, conclusions and recommendations will be submitted to the Manager of Accounting of the Commission by March 31st of each even-numbered year and associated working papers will be available to Commission Staff for review.

Q. Do you recommend any changes to the conditions of evidence of compliance with Section 7-204(b)(2) listed above?

A. Yes. I recommend changes to Condition 3 concerning the frequency of the submission of an internal audit report and to indicate the objective of such audit.

I recommend that Condition 3 be revised as follows:

~~CenturyTel, Gallatin River, and all their utility and non-utility affiliated sister and subsidiary companies will conduct an bi-annual internal audits, conducted in odd-numbered years, to test compliance with Section 7-204(b)(2) and 7-204(b)(3). The internal audit report documenting findings, conclusions and recommendations will be submitted to the Manager of Accounting of the Commission by March 31st of each even-numbered year and associated working papers will be available to Commission Staff for review.~~

The purpose of the internal audit will be to document the procedures performed and conclusions to determine that cost allocations between regulated and non-regulated activities are in compliance with Gallatin River's cost allocation manual filed with the Commission and that the cost allocation manual is correct and complete.

Q. Please explain your rationale for this recommendation.

A. The Commission currently requires that internal audits be performed on a routine annual basis to insure that there is no cross subsidization of non-regulated operations by the regulated operations of Illinois public utilities. Without additional rationale as to why it would only be appropriate and necessary to examine this issue every other year, I recommend that the internal audit be performed annually.

I also propose that the condition indicate the purpose of the internal audit so that there is no ambiguity as to what the internal audit should achieve. The internal audit should document the procedures performed and conclusions to determine that cost allocations between regulated and non-regulated activities are in compliance with Gallatin River's cost allocation manual that is filed with the Commission and that the cost allocation manual is correct and complete.

Q. Do you have any other concerns or comments?

A. Yes, I am concerned that Gallatin River has not filed a cost allocation manual with the Commission as required by 83 Ill. Adm. Code 711, and further directed by the Commission in the Orders in Docket Nos. 05-0013, 06-0683 and 07-0034 (Joint Applicants' Exhibit 1.01, 1.02, and 1.03, respectively). As such, before the Commission can enter an order in this proceeding, Gallatin River must provide evidence that it has on file with the Commission a cost allocation manual. I recommend that Mr. Bailey submit such evidence with his rebuttal testimony.

Q. What is your recommendation regarding the finding the Commission must make regarding compliance with Section 7-204(b)(2)?

A. I recommend that Condition 3 be modified to require an annual internal audit, the purposes of the internal audit be indicated, and that Gallatin River be required to submit evidence that a cost allocation manual has been filed with the Commission in order for the Commission to find that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers as required by Section 7-204(b)(2).

120 **Compliance with Section 7-204(b)(3)**

121 **Q. Describe the requirements of Section 7-204(b)(3).**

122 A. Section 7-204(b)(3) requires that, before approving a proposed reorganization,
123 the Commission find that costs and facilities are fairly and reasonably allocated
124 between utility and non-utility activities in such a manner that the Commission
125 may identify those costs and facilities which are properly included by the utility for
126 rate making purposes.

127 **Q. How does the proposed reorganization impact the ability of Gallatin River**
128 **to fairly and reasonably allocate costs and facilities between utility and**
129 **non-utility activities in such a manner that the Commission may identify**
130 **those costs and facilities which are properly included by the utility for**
131 **ratemaking purposes?**

132 A. The proposed reorganization of CenturyTel and Gallatin River does not impact
133 the ability of Gallatin River to fairly and reasonably allocate costs and facilities
134 between utility and non-utility activities in such a manner that the Commission
135 may identify those costs and facilities which are properly included by the utility for
136 ratemaking purposes. There is no change that will occur that affects the method
137 used by Gallatin River to reasonably allocate costs between utility and non-utility
138 activities. In direct testimony, Mr. Bailey testified that neither the Embarq
139 acquisition nor the change in ownership of CenturyTel will impact the ability of
140 Gallatin River to fairly allocate its costs and facilities between utility and non-
141 utility activities (Joint Applicants' Exhibit 1.0, pp. 18-19).

142 **Q. By what means can the Commission be assured that Gallatin River will**
143 **reasonably allocate its costs and facilities between utility and non-utility**
144 **activities?**

145 A. Gallatin River is subject to the cost allocation requirements of 83 Ill. Admin. Code
146 711, its cost allocation manual, and FCC cost allocation rules. The proposed
147 transaction will not change the existing cost allocation procedures or accounting
148 methods, as testified to by Mr. Bailey (Joint Applicants' Exhibit 1.0, pp. 18-19). In
149 addition, Gallatin River has agreed to the following conditions from the Order in
150 Docket No. 07-0043 as further evidence of compliance with Section 7-204(b)(3):

- 151 1. Commission Staff will be granted access to all books, accounts, records
152 and personnel of CenturyTel, Gallatin River, and all of their utility and non-
153 utility affiliated sister and subsidiary companies, as well as independent
154 auditor's working papers, to the extent permitted by the rules and policies
155 of the independent auditor;
- 156 2. Gallatin River will continue to comply with 83 Ill. Admin. Code 711, Cost
157 Allocation Rules for Large Local Exchange Carriers; and
- 158 3. CenturyTel, Gallatin River, and all their utility and non-utility affiliated sister
159 and subsidiary companies will conduct bi-annual internal audits,
160 conducted in odd-numbered years, to test compliance with Section 7-
161 204(b)(2) and 7-204(b)(3). The internal audit report documenting findings,
162 conclusions and recommendations will be submitted to the Manager of
163 Accounting of the Commission by March 31st of each even-numbered year
164 and associated working papers will be available to Commission Staff for
165 review.

166 **Q. Do you recommend any changes to the conditions of evidence of**
167 **compliance with Section 7-204(b)(3) listed above?**

168 A. Yes. I recommend changes to Condition 3 concerning the frequency of the
169 submission of an internal audit report and to indicate the objective of such audit.

170 I recommend that Condition 3 be revised as follows:

171 ~~CenturyTel, Gallatin River, and all their utility and non-utility affiliated sister~~
172 ~~and subsidiary companies will conduct an bi-annual internal audits,~~
173 ~~conducted in odd-numbered years,~~ to test compliance with Section 7-
174 204(b)(2) and 7-204(b)(3). The internal audit report ~~documenting findings,~~
175 ~~conclusions and recommendations~~ will be submitted to the Manager of
176 Accounting of the Commission by March 31st of each ~~even-numbered~~ year
177 and associated working papers will be available to Commission Staff for
178 review.

179 The purpose of the internal audit will be to document the procedures
180 performed and conclusions to determine that cost allocations between
181 regulated and non-regulated activities are in compliance with Gallatin
182 River's cost allocation manual filed with the Commission and that the cost
183 allocation manual is correct and complete.

184 **Q. Please explain your rationale for this recommendation.**

185 A. The Commission currently requires that internal audits be performed on a routine
186 annual basis to insure that there is no cross subsidization of non-regulated
187 operations by the regulated operations of Illinois public utilities. Without
188 additional rationale as to why it would only be appropriate and necessary to
189 examine this issue every other year, I recommend that the internal audit be
190 performed annually.

191 I also propose that the condition indicate the purpose of the internal audit so that
192 there is no ambiguity as to what the internal audit should achieve. The internal
193 audit should document the procedures performed and conclusions to determine
194 that cost allocations between regulated and non-regulated activities are in
195 compliance with Gallatin River's cost allocation manual that is filed with the
196 Commission and that the cost allocation manual is correct and complete.

197 **Q. Do you have any other concerns or comments?**

198 A. Yes, again, I am concerned that Gallatin River has not filed a cost allocation
199 manual with the Commission as required by 83 Ill. Adm. Code 711 and in
200 accordance with the Order in Docket Nos. 05-0013, 06-0683 and 07-0034 (Joint
201 Applicants' Exhibit 1.01, 1.02, and 1.03, respectively). As such, before the
202 Commission can enter an order in this proceeding, Gallatin River must provide
203 evidence that it has on file with the Commission a cost allocation manual. I
204 recommend that Mr. Bailey submit such evidence with his rebuttal testimony.

205 **Q. What is your recommendation regarding the finding the Commission must**
206 **make regarding compliance with Section 7-204(b)(3)?**

207 A. I recommend that Condition 3 be modified to require an annual internal audit, the
208 objectives of the internal audit be indicated, and that Gallatin River be required to
209 submit evidence that a cost allocation manual has been filed with the
210 Commission in order for the Commission to find that costs and facilities of
211 Gallatin River will be fairly and reasonably allocated between utility and non-utility
212 activities in such a manner that the Commission will be able to identify those
213 costs and facilities that are properly included for ratemaking purposes in
214 compliance with Section 7-204(b)(3).

215 **Finding Regarding Section 7-204(c)**

216 **Q. Describe the ruling the Commission must make to be in compliance with**
217 **Section 7-204(c).**

218 A. The Commission shall not approve a reorganization without ruling on 1) the
219 allocation of any savings resulting from the proposed reorganization; and 2)
220 whether the companies should be allowed to recover any costs incurred in
221 accomplishing the proposed reorganization and, if so, the amount of costs
222 eligible for recovery and how the costs will be allocated.

223 **Q. How do the Joint Applicants propose to allocate any savings resulting from**
224 **the proposed reorganization?**

225 A. Mr. Bailey testified that there are no savings anticipated by Gallatin River from its
226 regulated intrastate operations as a result of the reorganization (Joint Applicants'
227 Exhibit 1.0, page 23).

228 **Q. Are the Joint Applicants proposing to be allowed to recover any costs**
229 **incurred in accomplishing the proposed reorganization?**

230 A. Mr. Bailey testified that the Joint Applicants are not seeking in this proceeding,
231 nor will they seek in any other proceeding, to recover any costs Gallatin River
232 may incur in accomplishing the proposed reorganization (Joint Applicants' Exhibit
233 1.0, page 23).

234 **Q. What is your recommendation regarding the ruling the Commission must**
235 **make regarding Section 7-204(c)?**

236 A. I recommend that the Commission rule that: (1) the allocation of any savings
237 resulting from the proposed reorganization would flow through to the costs

238 associated with the regulated intrastate operations for consideration in setting
239 rates by the Commission; and (2) the Joint Applicants will not be allowed to
240 recover any costs incurred in accomplishing the proposed reorganization in
241 future rate proceedings.

242 **General Comments**

243 **Q. Do you have any general comments?**

244 A. Yes, I do. With all of the internal audit requirements of the various orders for this
245 Company, I recommend that the order in this proceeding clarify that the internal
246 audit reporting requirements agreed to by Gallatin River in Dockets No. 05-0013,
247 06-0683 and 07-0043 have been superseded by the above internal audit
248 reporting requirement.

249 **Recommendations**

250 **Q. What recommendations to you have for the Commission?**

251 A. I recommend that Condition 3 be modified to require an annual internal audit and
252 the objectives of the internal audit be indicated, and that the Company be
253 required to submit evidence that a cost allocation manual has been filed with the
254 Commission in order for the Commission find that the Joint Applicants are in
255 compliance with Sections 7-204(b)(2) and 7-204(b)(3).

256 In regards to Commission compliance with Section 7-204(c), I recommend that
257 the Commission rule that:

258 1) The allocation of any savings resulting from the proposed reorganization
259 would flow through to the costs associated with the regulated intrastate
260 operations for consideration in setting rates by the Commission; and

261 2) The Joint Applicants will not be allowed to recover any costs incurred in
262 accomplishing the proposed reorganization in future rate proceedings.

263 I also recommend that the order in this proceeding clarify that the internal audit
264 reporting requirements agreed to by Gallatin River in Dockets No. 05-0013, 06-
265 0683 and 07-0043 have been superseded by the above internal audit reporting
266 requirement.

267 **Conclusion**

268 **Q. Does this question end your direct testimony?**

269 **A. Yes.**